

**Introduced by Senator Runner**

February 20, 2007

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An act to amend Sections 17052.12, 17053.36, 17053.37, 23609, 23636, 23637, and 25120 of, to amend, add, and repeal Section 25128 of, and to add and repeal Sections 6357.7 and 6377 of, the Revenue and Taxation Code, relating to taxation, to take effect immediately, tax levy.

**LEGISLATIVE COUNSEL'S DIGEST**

SB 359, as introduced, Runner. Sales and use taxes: exemptions.

(1) The Sales and Use Tax Law imposes a tax on the gross receipts from the sale in this state of, or the storage, use, or other consumption in this state of, tangible personal property. That law provides various exemptions from that tax, including an exemption for the gross receipts from the sale of, and the storage, use, or other consumption of, fuel and petroleum products sold to an air common carrier for immediate consumption or shipment in the conduct of its business on an international flight.

This bill would, from January 1, 2007, until an unspecified date, exempt from those state taxes gross receipts in excess of \$1.88 per gallon derived from the sale in this state of, and the storage, use, or other consumption in this state of, fuel and petroleum products sold to or purchased by an air common carrier on a domestic flight, as specified.

(2) The Sales and Use Tax Law imposes a tax on the gross receipts from the sale in this state of, or the storage, use, or other consumption in this state of, tangible personal property and provides various exemptions from the taxes imposed by that law.

This bill would, for calendar years beginning on or after January 1, 2007, and before January 1, \_\_\_\_, allow an exemption from those taxes for the gross receipts from the sale of, and the storage, use, or other

consumption of, tangible personal property, as defined, purchased for use by a qualified person, as defined, engaged in the manufacturing, processing, refining, fabricating, or recycling of property, as specified.

(3) The Personal Income Tax Law and the Corporation Tax Law, by reference to a specified federal statute, allow a credit against taxes imposed by those laws for increasing research expenses, as defined. In general, the amount of the credit under both laws is equal to 15% of the excess of the qualified research expenses, as defined, for the taxable year over the base amount, as defined, and, in addition, for purposes of the Corporation Tax Law, 24% of the basic research payments, as defined. The term “base amount” means the product of the average annual gross receipts of the taxpayer for each of the specified years preceding the taxable year and the fixed-base percentage, as defined, but in no event less than 50% of the qualified research expenses for the taxable year. A taxpayer may elect an alternative incremental credit for increasing research expenses in modified conformity to federal income tax laws.

This bill would modify the credit for increasing research expenses to 16% of the excess of the qualified research expenses. This bill would also make modification to alternative incremental credit provided under those federal income tax laws.

(4) The Personal Income Tax Law and the Corporation Tax Law authorize various credits against the taxes imposed by those laws, including a credit against those taxes for specified taxable years, in an amount equal to a specified percentage of the qualified wages, as defined, paid, or incurred during the taxable or income year or in connection with an initial contract or subcontract to manufacture property for ultimate use in a Joint Strike Fighter, as specified. The Personal Income Tax Law and the Corporation Tax Law also authorize a credit against the taxes imposed by those laws for specified taxable years, in an amount equal to 10% of the qualified cost, as provided, of property for use in the manufacture of a product for ultimate use in a Joint Strike Fighter, as specified. Existing law provides that these provisions are repealed on December 1, 2006.

This bill would extend these credits to the manufacture of property for ultimate use as a Crew Exploration Vehicle, as defined, and would also extend the repeal date of these provisions to December 1, \_\_\_\_.

(5) The Corporation Tax Law imposes taxes measured by income and, in the case of a business with income derived from or attributable to sources both within and without this state, apportions the income

between this state and other states and foreign countries in accordance with a specified 4-factor formula based on the property, payroll, and sales within and without this state, except that in the case of an apportioning trade or business that derives more than 50% of its gross business receipts from conducting one or more qualified business activities, as defined, including an extractive business activity, business income is apportioned in accordance with a specified 3-factor formula.

This bill would permit, by election, business income of a qualified taxpayer, as defined, to be apportioned to this state, for taxable years beginning on or after January 1, 2007, and before January 1, \_\_\_\_, by multiplying the business income by a fraction, the numerator of which is the property factor plus the payroll factor plus 4 times the sales factor, and the denominator of which is 6.

This bill would also provide that, for taxable years beginning on or after January 1, 2007, and before January 1, \_\_\_\_, a taxpayer that is neither a qualified taxpayer nor engaged in a specified business activity must apportion its business income to this state in accordance with the 4-factor formula, and would specify that, with respect to a certain business activity, a trade or business would be allowed to apportion its business income based upon the revised formula or in accordance with the 3-factor formula, as provided, and would specify that, with respect to certain qualified business activities, a trade or business must apportion its business income to this state in accordance with the 3-factor formula.

This bill, for purposes of the sales factor, would provide that notwithstanding the Multistate Tax Compact, gross receipts would also define the term “total sales arising from a treasury function,” as defined, to mean only the overall net gain, including interest and dividends, realized by the taxpayer from transactions undertaken as part of its treasury function, as defined.

(6) Counties and cities are authorized to impose local sales and use taxes in conformity with state sales and use taxes. Exemptions from state sales and use taxes enacted by the Legislature are automatically incorporated into the local taxes.

This bill would specify that this exemption does not apply to local sales or transactions and use taxes, unless the governing body of the taxing county, city, or district votes otherwise.

(7) This bill would take effect immediately as a tax levy.

Vote: majority. Appropriation: no. Fiscal committee: yes.  
State-mandated local program: no.

*The people of the State of California do enact as follows:*

1     SECTION 1. Section 6357.7 is added to the Revenue and  
2     Taxation Code, to read:

3     6357.7. (a) From January 1, 2007, to December 31, \_\_\_\_\_,  
4     inclusive, there are exempted from the taxes imposed by this part,  
5     those gross receipts in excess of one dollar and eighty eight cents  
6     (\$1.88) per gallon derived from the sale in this state of, or the  
7     storage, use, or other consumption in this state of, fuel and  
8     petroleum products sold to or purchased by an air common carrier  
9     for consumption or shipment in the conduct of its business as an  
10    air common carrier, on a domestic flight.

11    (b) To qualify for the exemption, the air common carrier shall  
12    furnish to the seller an exemption certificate in the form prescribed  
13    by the board. Acceptance in good faith of that certificate shall  
14    relieve the seller from liability for the sales tax exempted under  
15    this section.

16    (c) For purposes of this section, the following definitions apply:

17    (1) "Air common carrier" has the same meaning as that set forth  
18    in Section 23046 of the Business and Professions Code.

19    (2) "Domestic flight" means a flight whose final destination is  
20    a point inside of the United States, including its territories.

21    (d) Any air common carrier claiming exemption under this  
22    section, who is not required to hold a valid seller's permit, shall  
23    be required to register with the board and obtain a fuel exemption  
24    registration number, and shall be required to file returns as the  
25    board may prescribe, either if the board notifies the carrier that  
26    returns must be filed or if the carrier is liable for taxes based upon  
27    consumption or transportation of fuel or petroleum products  
28    erroneously claimed as exempt under this section.

29    (e) An air common carrier claiming an exemption under this  
30    section, upon request, shall make available to the board records,  
31    including, but not limited to, a copy of a log abstract, an air waybill,  
32    or a cargo manifest, documenting its consumption or transportation  
33    of the fuel or petroleum products on a domestic flight and the  
34    amount claimed as exempt. If the carrier fails to provide these  
35    records upon request, the board may revoke the carrier's fuel  
36    exemption registration number.

37    (f) The board may require any air common carrier claiming an  
38    exemption under this section and required to obtain a fuel

1 exemption registration number, to place with it such security as  
2 the board may determine pursuant to Section 6701.

3 (g) Pursuant to this section, any use of the fuel and petroleum  
4 products by the purchasing carrier, other than that incident to the  
5 delivery of the fuel and petroleum products to the carrier and the  
6 consumption or transportation of the fuel and petroleum products  
7 by the carrier on a domestic flight for use in the conduct of its  
8 business as a common carrier, or a failure of the carrier to document  
9 its consumption or transportation of the fuel and petroleum  
10 products on a domestic flight, shall subject the carrier to liability  
11 for payment of sales tax as if it were a retailer making a retail sale  
12 of the property at the time of that use or failure, and the sales price  
13 of the property to it shall be deemed to be the gross receipts from  
14 the retail sale.

15 (h) Notwithstanding any provision of the Bradley-Burns  
16 Uniform Local Sales and Use Tax Law (Part 1.5 (commencing  
17 with Section 7200)) or the Transactions and Use Tax Law (Part  
18 1.6 (commencing with Section 7251)), the exemption established  
19 by this section shall not apply with respect to any tax levied by a  
20 county, city, or district pursuant to, or in accordance with, either  
21 of those laws, unless approved by the local government that would  
22 otherwise receive the revenues derived from the taxes imposed  
23 under those laws.

24 (i) This section shall remain in effect only until January 1, \_\_\_\_\_,  
25 and as of that date is repealed.

26 SEC. 2. Section 6377 is added to the Revenue and Taxation  
27 Code, to read:

28 6377. (a) For calendar years beginning on or after January 1,  
29 2007, there are exempted from the taxes imposed by this part the  
30 gross receipts from the sale of, and the storage, use, or other  
31 consumption in this state of, any of the following:

32 (1) Tangible personal property purchased for use by a qualified  
33 person to be used primarily in any stage of the manufacturing,  
34 processing, refining, fabricating, or recycling of property,  
35 beginning at the point any raw materials are received by the  
36 qualified person and introduced into the process and ending at the  
37 point at which the manufacturing, processing, refining, fabricating,  
38 or recycling has altered property to its completed form, including  
39 packaging, if required.

1 (2) Tangible personal property purchased for use by a qualified  
2 person to be used primarily in research and development.

3 (3) Tangible personal property purchased for use by a qualified  
4 person to be used primarily to maintain, repair, measure, or test  
5 any property described in paragraph (1), (2), or (3).

6 (4) Tangible personal property purchased for use by a contractor  
7 purchasing that property either as an agent of a qualified person  
8 or for the contractor's own account and subsequent resale to a  
9 qualified person for use in the performance of a construction  
10 contract for the qualified person who will use the tangible personal  
11 property as an integral part of the manufacturing, processing,  
12 refining, fabricating, or recycling process, or as a research or  
13 storage facility for use in connection with the manufacturing  
14 process.

15 (b) This exemption does not apply to any tangible personal  
16 property that is used primarily in administration, general  
17 management, or marketing.

18 (c) For purposes of this section:

19 (1) "Fabricating" means to make, build, create, produce, or  
20 assemble components or property to work in a new or different  
21 manner.

22 (2) "Manufacturing" means the activity of converting or  
23 conditioning property by changing the form, composition, quality,  
24 or character of the property for ultimate sale at retail or use in the  
25 manufacturing of a product to be ultimately sold at retail.  
26 Manufacturing includes any improvements to tangible personal  
27 property that result in a greater service life or greater functionality  
28 than that of the original property.

29 (3) "Primarily" means tangible personal property used 50 percent  
30 or more of the time in an activity described in subdivision (a).

31 (4) (A) "Process" means the period beginning at the point at  
32 which any raw materials are received by the qualified taxpayer  
33 and introduced into the manufacturing, processing, refining,  
34 fabricating, or recycling activity of the qualified taxpayer and  
35 ending at the point at which the manufacturing, processing,  
36 refining, fabricating, or recycling activity of the qualified taxpayer  
37 has altered tangible personal property to its completed form,  
38 including packaging, if required. Raw materials shall be considered  
39 to have been introduced into the process when the raw materials  
40 are stored on the same premises where the qualified taxpayer's

1 manufacturing, processing, refining, fabricating, or recycling  
2 activity is conducted.

3 (B) Raw materials that are stored on premises other than where  
4 the qualified taxpayer's manufacturing, processing, refining,  
5 fabricating, or recycling activity is conducted, shall not be  
6 considered to have been introduced into the manufacturing,  
7 processing, refining, fabricating, or recycling process.

8 (5) "Processing" means the physical application of the materials  
9 and labor necessary to modify or change the characteristics of  
10 property.

11 (6) "Qualified person" means any person that is both of the  
12 following:

13 (A) A new trade or business. In determining whether a trade or  
14 business activity qualifies as a new trade or business, the following  
15 rules shall apply:

16 (i) In any case where a person purchases or otherwise acquires  
17 all or any portion of the assets of an existing trade or business  
18 (irrespective of the form of entity) that is doing business in this  
19 state (within the meaning of Section 23101), the trade or business  
20 thereafter conducted by that person (or any related person) shall  
21 not be treated as a new business if the aggregate fair market value  
22 of the acquired assets (including, real, personal, tangible, and  
23 intangible property) used by that person (or any related person) in  
24 the conduct of his or her trade or business exceeds 20 percent of  
25 the aggregate fair market value of the total assets of the trade or  
26 business being conducted by the person (or any related person).  
27 For purposes of this subparagraph only, the following rules shall  
28 apply:

29 (I) The determination of the relative fair market values of the  
30 acquired assets and the total assets shall be made as of the last day  
31 of the month following the quarterly period in which the person  
32 (or any related person) first uses any of the acquired trade or  
33 business assets in his or her business activity.

34 (II) Any acquired assets that constituted property described in  
35 Section 1221(1) of the Internal Revenue Code in the hands of the  
36 transferor shall not be treated as assets acquired from an existing  
37 trade or business, unless those assets also constitute property  
38 described in Section 1221(1) of the Internal Revenue Code in the  
39 hands of the acquiring person (or related person).

(ii) In any case where a person (or any related person) is engaged in one or more trade or business activities in this state, or has been engaged in one or more trade or business activities in this state within the preceding 36 months (“prior trade or business activity”), and thereafter commences an additional trade or business activity in this state, the additional trade or business activity shall only be treated as a new business if the additional trade or business activity is classified under a different division of the Standard Industrial Classification Manual published by the United States Office of Management and Budget, 1987 edition, than are any of the person’s (or any related person’s) current or prior trade or business activities in this state.

(iii) In any case where a person, including all related persons, is engaged in trade or business activities wholly outside of this state and that person first commences doing business in this state (within the meaning of Section 23101) after December 31, 1993 (other than by purchase or other acquisition described in clause (i)), the trade or business activity shall be treated as a new business.

(iv) In any case where the legal form under which a trade or business activity is being conducted is changed, the change in form shall be disregarded and the determination of whether the trade or business activity is a new business shall be made by treating the person as having purchased or otherwise acquired all or any portion of the assets of an existing trade or business under the rules of clause (i).

(v) “Related person” means any person that is related to that person under either Section 267 or 318 of the Internal Revenue Code.

(vi) “Acquire” includes any gift, inheritance, transfer incident to divorce, or any other transfer, whether or not for consideration.

(B) Engaged in those lines of business described in Codes 2011 to 3999, inclusive, and Codes 7371 to 7373, inclusive, of the Standard Industrial Classification Manual published by the United States Office of Management and Budget, 1987 edition, or engaged in telecommunication activities.

(7) Notwithstanding paragraph (6), “qualified person” shall not include any person who has conducted business activities in a new trade or business for three or more years.

(8) “Recycling” means using, reusing, or reclaiming a recyclable material to produce new or recycled property.



1 (9) “Refining” means the process of converting a natural  
2 resource to an intermediate or finished product.

3 (10) “Research and development” means those activities that  
4 are described in Section 174 of the Internal Revenue Code or in  
5 any regulations promulgated under that section.

6 (11) “Tangible personal property” does not include any of the  
7 following:

8 (A) Consumables with a normal useful life of less than one year,  
9 except as provided in subparagraph (E) of paragraph (11).

10 (B) Furniture, inventory, equipment used in the extraction  
11 process, or equipment used to store finished products that have  
12 completed the manufacturing process.

13 (12) “Tangible personal property” includes, but is not limited  
14 to, all of the following:

15 (A) Machinery and equipment, including component parts and  
16 contrivances such as belts, shafts, moving parts, and operating  
17 structures.

18 (B) All equipment or devices used or required to operate,  
19 control, regulate, or maintain the machinery, including, without  
20 limitation, computers, data processing equipment, and computer  
21 software, together with all repair and replacement parts with a  
22 useful life of one or more years, whether purchased separately or  
23 in conjunction with a complete machine and regardless of whether  
24 the machine or component parts are assembled by the taxpayer or  
25 another party.

26 (C) Property used in pollution control that meets or exceeds  
27 standards established by this state or any local or regional  
28 governmental agency within this state.

29 (D) Special purpose buildings and foundations used as an  
30 integral part of the manufacturing, processing, refining, or  
31 fabricating process, or that constitute a research or storage facility  
32 used during the manufacturing process. Buildings used solely for  
33 warehousing purposes after completion of the manufacturing  
34 process are not included.

35 (E) Fuels used or consumed in the manufacturing process.

36 (F) Property used in recycling.

37 (d) No exemption is allowed under this section unless the  
38 purchaser furnishes the retailer with an exemption certificate,  
39 completed in accordance with any instructions or regulations as  
40 the board may prescribe, and the retailer subsequently furnishes

1 the board with a copy of the exemption certificate. The exemption  
2 certificate shall contain the sales price of the machinery or  
3 equipment that is exempt pursuant to subdivision (a).

4 (e) Notwithstanding any provision of the Bradley-Burns Uniform  
5 Local Sales and Use Tax Law (Part 1.5 (commencing with Section  
6 7200)) or the Transactions and Use Tax Law (Part 1.6  
7 (commencing with Section 7251)), the exemption established by  
8 this section does not apply with respect to any tax levied by a  
9 county, city, or district pursuant to, or in accordance with, either  
10 of those laws.

11 (f) (1) Notwithstanding subdivision (a), the exemption provided  
12 by this section does not apply to any sale or use of property which,  
13 within one year from the date of purchase, is either removed from  
14 California or converted from an exempt use under subdivision (a)  
15 to some other use not qualifying for the exemption.

16 (2) The exemption established by this section does not apply  
17 with respect to any tax levied pursuant to Sections 6051.2 and  
18 6201.2, or pursuant to Section 35 of Article XIII of the California  
19 Constitution.

20 (g) If a purchaser certifies in writing to the seller that the  
21 property purchased without payment of the tax will be used in a  
22 manner entitling the seller to regard the gross receipts from the  
23 sale as exempt from the sales tax, and within one year from the  
24 date of purchase, the purchaser (1) removes that property outside  
25 California, (2) converts that property for use in a manner not  
26 qualifying for the exemption, or (3) uses that property in a manner  
27 not qualifying for the exemption, the purchaser shall be liable for  
28 payment of sales tax, with applicable interest, as if the purchaser  
29 were a retailer making a retail sale of the property at the time the  
30 property is so removed, converted, or used, and the sales price of  
31 the property to the purchaser shall be deemed the gross receipts  
32 from that retail sale.

33 (h) This section applies to leases of tangible personal property  
34 classified as “continuing sales” and “continuing purchases” in  
35 accordance with Sections 6006.1 and 6010.1. The exemption  
36 established by this section applies to the rentals payable pursuant  
37 to a lease, provided the lessee is a qualified person and the property  
38 is used in an activity described in subdivision (a). Rentals that  
39 meet the foregoing requirements are eligible for the exemption for  
40 a period of six years from the date of commencement of the lease.

1 At the close of the six-year period from the date of commencement  
2 of the lease, lease receipts are subject to tax without exemption.

3 (i) This section shall remain in effect only until January 1, \_\_\_\_\_,  
4 and as of that date is repealed.

5 SEC. 3. Section 17052.12 of the Revenue and Taxation Code  
6 is amended to read:

7 17052.12. For each taxable year beginning on or after January  
8 1, 1987, there shall be allowed as a credit against the “net tax” (as  
9 defined by Section 17039) for the taxable year an amount  
10 determined in accordance with Section 41 of the Internal Revenue  
11 Code, except as follows:

12 (a) For each taxable year beginning before January 1, 1997, the  
13 reference to “20 percent” in Section 41(a)(1) of the Internal  
14 Revenue Code is modified to read “8 percent.”

15 (b) (1) For each taxable year beginning on or after January 1,  
16 1997, and before January 1, 1999, the reference to “20 percent”  
17 in Section 41(a)(1) of the Internal Revenue Code is modified to  
18 read “11 percent.”

19 (2) For each taxable year beginning on or after January 1, 1999,  
20 and before January 1, 2000, the reference to “20 percent” in Section  
21 41(a)(1) of the Internal Revenue Code is modified to read “12  
22 percent.”

23 (3) For each taxable year beginning on or after January 1, 2000,  
24 *and before January 1, 2007*, the reference to “20 percent” in  
25 Section 41(a)(1) of the Internal Revenue Code is modified to read  
26 “15 percent.”

27 (4) *For each taxable year beginning on or after January 1,*  
28 *2007, the reference to “20 percent” in Section 41(a)(1) of the*  
29 *Internal Revenue Code is modified to read “16 percent.”*

30 (c) Section 41(a)(2) of the Internal Revenue Code, relating to  
31 basic research payments, shall not apply.

32 (d) “Qualified research” shall include only research conducted  
33 in California.

34 (e) In the case where the credit allowed under this section  
35 exceeds the “net tax,” the excess may be carried over to reduce  
36 the “net tax” in the following year, and succeeding years if  
37 necessary, until the credit has been exhausted.

38 (f) (1) With respect to any expense paid or incurred after the  
39 operative date of Section 6378, Section 41(b)(1) of the Internal  
40 Revenue Code is modified to exclude from the definition of

1 “qualified research expense” any amount paid or incurred for  
2 tangible personal property that is eligible for the exemption from  
3 sales or use tax ~~provided by~~ *under* Section 6378.

4 (2) For each taxable year beginning on or after January 1, 1998,  
5 the reference to “Section 501(a)” in Section 41(b)(3)(C) of the  
6 Internal Revenue Code, relating to contract research expenses, is  
7 modified to read “this part or Part 11 (commencing with Section  
8 23001).”

9 (g) (1) For each taxable year beginning on or after January 1,  
10 2000, *and before January 1, 2007*:

11 (A) The reference to “2.65 percent” in Section 41(c)(4)(A)(i)  
12 of the Internal Revenue Code is modified to read “one and  
13 forty-nine hundredths of one percent.”

14 (B) The reference to “3.2 percent” in Section 41(c)(4)(A)(ii) of  
15 the Internal Revenue Code is modified to read “one and  
16 ninety-eight hundredths of one percent.”

17 (C) The reference to “3.75 percent” in Section 41(c)(4)(A)(iii)  
18 of the Internal Revenue Code is modified to read “two and  
19 forty-eight hundredths of one percent.”

20 (2) *For each taxable year beginning on or after January 1,*  
21 *2007, the following apply:*

22 (A) *The reference to “2.65 percent” in Section 41(c)(4)(A)(i)*  
23 *of the Internal Revenue Code is modified to read “two percent.”*

24 (B) *The reference to “3.2 percent” in Section 41(c)(4)(A)(ii) of*  
25 *the Internal Revenue Code is modified to read “two and one-half*  
26 *percent.”*

27 (C) *The reference to “3.75 percent” in Section 41(c)(4)(A)(iii)*  
28 *of the Internal Revenue Code is modified to read “three percent.”*

29 (3) Section 41(c)(4)(B) shall not apply and in lieu thereof an  
30 election under Section 41(c)(4)(A) of the Internal Revenue Code  
31 may be made for any taxable year of the taxpayer beginning on or  
32 after January 1, 1998. That election shall apply to the taxable year  
33 for which made and all succeeding taxable years unless revoked  
34 with the consent of the Franchise Tax Board.

35 ~~(3)~~

36 (4) Section 41(c)(6) of the Internal Revenue Code, relating to  
37 gross receipts, is modified to take into account only those gross  
38 receipts from the sale of property held primarily for sale to  
39 customers in the ordinary course of the taxpayer’s trade or business

1 that is delivered or shipped to a purchaser within this state,  
2 regardless of f.o.b. point or any other condition of the sale.

3 (h) Section 41(h) of the Internal Revenue Code, relating to  
4 termination, shall not apply.

5 (i) Section 41(g) of the Internal Revenue Code, relating to  
6 special rule for passthrough of credit, is modified by each of the  
7 following:

8 (1) The last sentence shall not apply.

9 (2) If the amount determined under Section 41(a) of the Internal  
10 Revenue Code for any taxable year exceeds the limitation of  
11 Section 41(g) of the Internal Revenue Code, that amount may be  
12 carried over to other taxable years under the rules of subdivision  
13 (e); except that the limitation of Section 41(g) of the Internal  
14 Revenue Code shall be taken into account in each subsequent  
15 taxable year.

16 SEC. 4. Section 17053.36 of the Revenue and Taxation Code  
17 is amended to read:

18 17053.36. (a) For each taxable year beginning on or after  
19 January 1, 2001, and before January 1, ~~2006~~ \_\_\_\_\_, a qualified  
20 taxpayer shall be allowed as a credit against the “net tax,” as  
21 defined in Section 17039, an amount equal to the following:

22 (1) Fifty percent of qualified wages paid or incurred during any  
23 taxable year beginning on or after January 1, 2001, and before  
24 January 1, 2002.

25 (2) Forty percent of qualified wages paid or incurred during any  
26 taxable year beginning on or after January 1, 2002, and before  
27 January 1, 2003.

28 (3) Thirty percent of the qualified wages paid or incurred during  
29 any taxable year beginning on or after January 1, 2003, and before  
30 January 1, 2004.

31 (4) Twenty percent of the qualified wages paid or incurred  
32 during any taxable year beginning on or after January 1, 2004, and  
33 before January 1, 2005.

34 (5) Ten percent of the qualified wages paid or incurred during  
35 any taxable year beginning on or after January 1, 2005, and before  
36 January 1, ~~2006~~ \_\_\_\_\_.

37 (b) For purposes of this section:

38 (1) (A) “Qualified taxpayer” means any taxpayer under an  
39 initial contract or subcontract to manufacture property for ultimate  
40 use in a Joint Strike Fighter *or a Crew Exploration Vehicle*.

(B) In the case of any ~~pass-through~~ *passthrough* entity, the determination of whether a taxpayer is a qualified taxpayer under this section shall be made at the entity level and any credit under this section or Section 23636 shall be allowed to the ~~pass-through~~ *passthrough* entity and passed through to the partners or shareholders in accordance with applicable provisions of this part or Part 11 (commencing with Section 23001). For purposes of this paragraph, ~~“pass-through”~~ *“passthrough entity”* means any partnership or ~~S~~ “S” corporation.

(2) “Qualified wages” means that portion of wages paid or incurred by the qualified taxpayer during the taxable year with respect to qualified employees that are direct costs as defined in Section 263A of the Internal Revenue Code allocable to property manufactured in this state by the qualified taxpayer for ultimate use in a Joint Strike Fighter *or a Crew Exploration Vehicle*.

(3) “Qualified employee” means an individual whose services for the qualified taxpayer are performed in this state and are at least 90 percent directly related to the qualified taxpayer’s contract or subcontract to manufacture property for ultimate use in a Joint Strike Fighter *or a Crew Exploration Vehicle*.

(4) “Joint Strike Fighter” means the next generation air combat strike aircraft developed and produced under the Joint Strike Fighter program.

(5) “Joint Strike Fighter program” means the multiservice, multinational project conducted by the United States government to develop and produce the next generation of air combat strike aircraft.

(6) *“Crew Exploration Vehicle” means the next generation spacecraft being planned by the National Aeronautics and Space Administration.*

(c) The credit allowed by this section shall not exceed ten thousand dollars (\$10,000) per year, per qualified employee. For employees that are qualified employees for part of a taxable year, the credit shall not exceed ten thousand dollars (\$10,000) multiplied by a fraction, the numerator of which is the number of months of the taxable year that the employee is a qualified employee and the denominator of which is 12.

(d) In the case where the credit allowed by this section exceeds the “net tax,” the excess may be carried over to reduce the “net

1 tax” in the following year, and the seven succeeding years if  
2 necessary, until the credit is exhausted.

3 (e) No credit shall be allowed unless the credit is reflected within  
4 the bid upon which the qualified taxpayer’s contract or subcontract  
5 to manufacture property for ultimate use in a Joint Strike Fighter  
6 *or a Crew Exploration Vehicle* is based by reducing the amount  
7 of the bid by the amount of the credit allowable.

8 (f) All references to the credit and ultimate cost reductions  
9 incorporated into any successful bid that was awarded a contract  
10 or subcontract and for which a qualified taxpayer is making a claim  
11 shall be made available to the Franchise Tax Board upon request.

12 (g) This section shall remain in effect only until December 1,  
13 2006 \_\_\_\_, and as of that date is repealed.

14 SEC. 5. Section 17053.37 of the Revenue and Taxation Code  
15 is amended to read:

16 17053.37. (a) For each taxable year beginning on or after  
17 January 1, 2001, and before January 1, 2006 \_\_\_\_, a qualified  
18 taxpayer shall be allowed as a credit against the “net tax,” as  
19 defined in Section 17039, an amount equal to 10 percent of the  
20 qualified cost of qualified property that is placed in service in this  
21 state.

22 (b) (1) For purposes of this section, “qualified cost” means any  
23 costs that satisfy each of the following conditions:

24 (A) Except as otherwise provided in this subparagraph, is a cost  
25 paid or incurred by the qualified taxpayer for the construction,  
26 reconstruction, or acquisition of qualified property on or after  
27 January 1, 2001, and before January 1, 2006 \_\_\_\_. In the case of  
28 any qualified property constructed, reconstructed, or acquired by  
29 the qualified taxpayer (or any person related to the qualified  
30 taxpayer within the meaning of Section 267 or 707 of the Internal  
31 Revenue Code) pursuant to a binding contract in existence on or  
32 before January 1, 2001, costs paid pursuant to that contract shall  
33 be subject to allocation as follows. Contract costs shall be allocated  
34 to qualified property based on a ratio of costs actually paid prior  
35 to January 1, 2001, and total contract costs actually paid. “Cost  
36 paid” shall include, without limitation, contractual deposits and  
37 option payments. To the extent of costs allocated, whether or not  
38 currently deductible or depreciable for tax purposes, to a period  
39 prior to January 1, 2001, the cost shall be deemed allocated to

1 property acquired before January 1, 2001, and is thus not a  
2 “qualified cost.”

3 (B) Except for capitalized labor costs as described in  
4 subparagraph (B) of paragraph (1) of subdivision (d), is an amount  
5 upon which the qualified taxpayer has paid, directly or indirectly,  
6 as a separately stated contract amount or as determined from the  
7 records of the qualified taxpayer, sales or use tax under Part 1  
8 (commencing with Section 6001).

9 (C) Is an amount properly chargeable to the capital account of  
10 the qualified taxpayer.

11 (2) (A) For purposes of this subdivision, any contract entered  
12 into on or after January 1, 2001, that is a successor or replacement  
13 contract to a contract that was binding before January 1, 2001,  
14 shall be treated as a binding contract in existence before January  
15 1, 2001.

16 (B) If a successor or replacement contract is entered into on or  
17 after January 1, 2001, and the subject of the successor or  
18 replacement contract relates both to amounts for the construction,  
19 reconstruction, or acquisition of qualified property described in  
20 the original binding contract and to costs for the construction,  
21 reconstruction, or acquisition of qualified property not described  
22 in the original binding contract, then the portion of those amounts  
23 described in the successor or replacement contract that were not  
24 described in the original binding contract shall not be treated as  
25 costs paid or incurred pursuant to a binding contract in existence  
26 on or prior to January 1, 2001, under subparagraph (A) of paragraph  
27 (1).

28 (3) (A) For purposes of this section, an option contract in  
29 existence before January 1, 2001, under which a qualified taxpayer  
30 (or any other person related to the qualified taxpayer within the  
31 meaning of Section 267 or 707 of the Internal Revenue Code) had  
32 an option to acquire qualified property, shall be treated as a binding  
33 contract under the rules in paragraph (2). For purposes of this  
34 subparagraph, an option contract shall not include an option under  
35 which the optionholder will forfeit an amount less than 10 percent  
36 of the fixed option price in the event the option is not exercised.

37 (B) For purposes of this section, a contract shall be treated as  
38 binding even if the contract is subject to a condition.

39 (c) (1) For purposes of this section, “qualified taxpayer” means  
40 any taxpayer under an initial contract or subcontract to manufacture



1 property for ultimate use in a Joint Strike Fighter *or a Crew*  
2 *Exploration Vehicle*.

3 (2) In the case of any passthrough entity, the determination of  
4 whether a taxpayer is a qualified taxpayer under this section shall  
5 be made at the entity level and any credit under this section or  
6 Section 23637 shall be allowed to the passthrough entity and passed  
7 through to the partners or shareholders in accordance with  
8 applicable provisions of Part 10 (commencing with Section 17001)  
9 or Part 11 (commencing with Section 23001). For purposes of this  
10 paragraph, the term “passthrough entity” means any partnership  
11 or ~~S~~ “S” corporation.

12 (3) The Franchise Tax Board may prescribe regulations to carry  
13 out the purposes of this section, including any regulations necessary  
14 to prevent the avoidance of the effect of this section through  
15 splitups, shell corporations, partnerships, tiered ownership  
16 structures, sale-leaseback transactions, or otherwise.

17 (d) (1) For purposes of this section, “qualified property” means  
18 property that is described as either of the following:

19 (A) Tangible personal property that is defined in Section  
20 1245(a)(3)(A) of the Internal Revenue Code for use by a qualified  
21 taxpayer primarily in qualified activities to manufacture a product  
22 for ultimate use in a Joint Strike Fighter *or a Crew Exploration*  
23 *Vehicle*.

24 (B) The value of any capitalized labor costs that are direct costs  
25 as defined in Section 263A of the Internal Revenue Code allocable  
26 to the construction or modification of property described in  
27 subparagraph (A).

28 (2) Qualified property does not include any of the following:

29 (A) Furniture.

30 (B) Inventory.

31 (C) Equipment used to store finished products that have  
32 completed the manufacturing process.

33 (D) Any tangible personal property that is used in administration,  
34 general management, or marketing.

35 (e) For purposes of this section:

36 (1) “*Crew Exploration Vehicle*” means the next generation  
37 spacecraft being planned by the National Aeronautics and Space  
38 Administration.

39 (H)

1 (2) “Fabricating” means to make, build, create, produce, or  
2 assemble components or property to work in a new or different  
3 manner.

4 ~~(2)~~

5 (3) “Joint Strike Fighter” means the next generation air combat  
6 strike aircraft developed and produced under the Joint Strike  
7 Fighter program.

8 ~~(3)~~

9 (4) “Joint Strike Fighter program” means the multiservice,  
10 multinational project conducted by the United States government  
11 to develop and produce the next generation of air combat strike  
12 aircraft.

13 ~~(4)~~

14 (5) “Manufacturing” means the activity of converting or  
15 conditioning property by changing the form, composition, quality,  
16 or character of the property for ultimate use in a Joint Strike Fighter  
17 *or a Crew Exploration Vehicle*. Manufacturing includes any  
18 improvements to tangible personal property that result in a greater  
19 service life or greater functionality than that of the original  
20 property.

21 ~~(5)~~

22 (6) “Primarily” means tangible personal property used 50 percent  
23 or more of the time in an activity described in subparagraph (A)  
24 of paragraph (1) of subdivision (d).

25 ~~(6)~~

26 (7) “Process” means the period beginning at the point at which  
27 any raw materials are received by the qualified taxpayer and  
28 introduced into the manufacturing, processing, or fabricating  
29 activity of the qualified taxpayer and ending at the point at which  
30 the manufacturing, processing, or fabricating activity of the  
31 qualified taxpayer has altered tangible personal property to its  
32 completed form, including packaging, if required. Raw materials  
33 shall be considered to have been introduced into the process when  
34 the raw materials are stored on the same premises where the  
35 qualified taxpayer’s manufacturing, processing, or fabricating  
36 activity is conducted. Raw materials that are stored on premises  
37 other than where the qualified taxpayer’s manufacturing,  
38 processing, or fabricating activity is conducted, shall not be  
39 considered to have been introduced into the manufacturing,  
40 processing, or fabricating process.

~~(7)~~

(8) “Processing” means the physical application of the materials and labor necessary to modify or change the characteristics of property.

~~(8)~~

(9) “Qualified activities” means manufacturing, processing, or fabricating of property, beginning at the point at which any raw materials are received by the qualified taxpayer and introduced into the process and ending at the point at which the manufacturing, processing, or fabricating has altered tangible personal property to its completed form, including packaging, if required.

(f) The credit allowed under subdivision (a) shall apply to qualified property that is acquired by or subject to lease by a qualified taxpayer, subject to the following special rules:

(1) A lessor of qualified property, irrespective of whether the lessor is a qualified taxpayer, shall not be allowed the credit provided under subdivision (a) with respect to any qualified property leased to another qualified taxpayer.

(2) For purposes of paragraphs (2) and (3) of subdivision (b), “binding contract” includes any lease agreement with respect to the qualified property.

(3) (A) For purposes of determining the qualified cost paid or incurred by a lessee in any leasing transaction that is not treated as a sale under Part 1 (commencing with Section 6001), the following rules shall apply:

(i) Except as provided by subparagraph (C) of this paragraph, subparagraphs (A) and (C) of paragraph (1) of subdivision (b) shall not apply.

(ii) Except as provided in subparagraph (B) and clause (iii), the “qualified cost” upon which the lessee shall compute the credit provided under this section shall be equal to the original cost to the lessor (within the meaning of Section 18031) of the qualified property that is the subject of the lease.

(iii) The requirement of subparagraph (B) of paragraph (1) of subdivision (b) shall be treated as satisfied only if the lessor has made a timely election under either Section 6094.1 or subdivision (d) of Section 6244 and has paid sales tax reimbursement or use tax measured by the purchase price of the qualified property (within the meaning of paragraph (5) of subdivision (g) of Section 6006). For purposes of this subdivision, the amount of original cost to

1 the lessor which may be taken into account under clause (ii) shall  
2 not exceed the purchase price upon which sales tax reimbursement  
3 or use tax has been paid under the preceding sentence.

4 (B) For purposes of applying subparagraph (A) only, the  
5 following special rules shall apply:

6 (i) The original cost to the lessor of the qualified property shall  
7 be reduced by the amount of any original cost of that property that  
8 was taken into account by a predecessor lessee in computing the  
9 credit allowable under this section.

10 (ii) Clause (i) shall not apply in any case where the predecessor  
11 lessee was required to recapture the credit provided under this  
12 section pursuant to the provisions of subdivision (g).

13 (iii) For purposes of this section only, in any case where a  
14 successor lessor has acquired qualified property from a predecessor  
15 lessor in a transaction not treated as a sale under Part 1  
16 (commencing with Section 6001), the original cost to the successor  
17 lessor of the qualified property shall be reduced by the amount of  
18 the original cost of the qualified property that was taken into  
19 account by any lessee of the predecessor lessor in computing the  
20 credit allowable under this section.

21 (C) In determining the original cost of any qualified property  
22 under this paragraph, only amounts paid or incurred by the lessor  
23 on or after January 1, 2001, and before January 1, ~~2006~~ \_\_\_\_\_, shall  
24 be taken into account. In the case of any qualified property  
25 constructed, reconstructed, or acquired by a lessor pursuant to a  
26 binding contract in existence on or prior to January 1, 2001, the  
27 allocation rule specified in subparagraph (A) of paragraph (1) of  
28 subdivision (b) shall apply in determining the original cost to the  
29 lessor of qualified property.

30 (D) Notwithstanding subparagraph (A), in the case of any leasing  
31 transaction for which the lessee is allowed the credit under this  
32 section and thereafter the lessee (or any party related to the lessee  
33 within the meaning of Section 267 or 318 of the Internal Revenue  
34 Code) acquires the qualified property from the lessor (or any  
35 successor lessor) within one year from the date the qualified  
36 property is first used by the lessee under the terms of the lease, the  
37 lessee's (or related party's) acquisition of the qualified property  
38 from the lessor (or successor lessor) shall be treated as a disposition  
39 by the lessee of the qualified property that was subject to the lease  
40 under subdivision (g).

1 (4) For purposes of determining the qualified cost paid or  
2 incurred by a lessee in any leasing transaction that is treated as a  
3 sale under Part 1 (commencing with Section 6001), the following  
4 rules shall apply:

5 (A) Subparagraph (A) of paragraph (1) of subdivision (b) shall  
6 be applied by substituting the term “purchase” for the term  
7 “construction, reconstruction, or acquisition.”

8 (B) Subparagraph (C) of paragraph (1) of subdivision (b) shall  
9 apply.

10 (C) The requirement of subparagraph (B) of paragraph (1) of  
11 subdivision (b) shall be treated as satisfied at the time that either  
12 the lessor or the qualified taxpayer pays sales or use tax under Part  
13 1 (commencing with Section 6001).

14 (5) (A) In the case of any leasing transaction described in  
15 paragraph (3), the lessor shall provide a statement to the lessee  
16 specifying the amount of the lessor’s original cost of the qualified  
17 property and the amount of that cost upon which a sales or use tax  
18 was paid within 45 days after the close of the lessee’s taxable year  
19 in which the credit is allowable to the lessee under this section.

20 (B) The statement required under subparagraph (A) shall be  
21 made available to the Franchise Tax Board upon request.

22 (g) No credit shall be allowed if the qualified property is  
23 removed from the state, is disposed of to an unrelated party, or is  
24 used for any purpose not qualifying for the credit provided in this  
25 section in the same taxable year in which the taxpayer first places  
26 the qualified property in service in this state. If any qualified  
27 property for which a credit is allowed pursuant to this section is  
28 thereafter removed from this state, disposed of to an unrelated  
29 party, or used for any purpose not qualifying for the credit provided  
30 in this section within one year from the date the taxpayer first  
31 places the qualified property in service in this state, the amount of  
32 the credit allowed by this section for that qualified property shall  
33 be recaptured by adding that credit amount to the net tax of the  
34 qualified taxpayer for the taxable year in which the qualified  
35 property is disposed of, removed, or put to an ineligible use.

36 (h) In the case where the credit allowed by this section exceeds  
37 the “net tax,” the excess may be carried over to reduce the “net  
38 tax” in the following year, and the seven succeeding years if  
39 necessary, until the credit is exhausted.

1 (i) (1) No credit shall be allowed under this section if a credit  
2 is claimed under Section 17053.49 in connection with the same  
3 property.

4 (2) No credit shall be allowed unless the credit is reflected within  
5 the bid upon which the qualified taxpayer's contract or subcontract  
6 to manufacture property for ultimate use in a Joint Strike Fighter  
7 *or a Crew Exploration Vehicle* is based by reducing the amount  
8 of the bid by the amount of the credit allowable.

9 (j) All references to the credit and ultimate cost reductions  
10 incorporated into any successful bid that was awarded a contract  
11 or subcontract and for which a qualified taxpayer is making a claim  
12 shall be made available to the Franchise Tax Board upon request.

13 (k) This section shall remain in effect only until December 1,  
14 2006 \_\_\_\_, and as of that date is repealed.

15 SEC. 6. Section 23609 of the Revenue and Taxation Code is  
16 amended to read:

17 23609. For each taxable year beginning on or after January 1,  
18 1987, there shall be allowed as a credit against the "tax" (as defined  
19 by Section 23036) an amount determined in accordance with  
20 Section 41 of the Internal Revenue Code, except as follows:

21 (a) For each taxable year beginning before January 1, 1997,  
22 both of the following modifications shall apply:

23 (1) The reference to "20 percent" in Section 41(a)(1) of the  
24 Internal Revenue Code is modified to read "8 percent."

25 (2) The reference to "20 percent" in Section 41(a)(2) of the  
26 Internal Revenue Code is modified to read "12 percent."

27 (b) (1) For each taxable year beginning on or after January 1,  
28 1997, and before January 1, 1999, both of the following  
29 modifications shall apply:

30 (A) The reference to "20 percent" in Section 41(a)(1) of the  
31 Internal Revenue Code is modified to read "11 percent."

32 (B) The reference to "20 percent" in Section 41(a)(2) of the  
33 Internal Revenue Code is modified to read "24 percent."

34 (2) For each taxable year beginning on or after January 1, 1999,  
35 and before January 1, 2000, both of the following shall apply:

36 (A) The reference to "20 percent" in Section 41(a)(1) of the  
37 Internal Revenue Code is modified to read "12 percent."

38 (B) The reference to "20 percent" in Section 41(a)(2) of the  
39 Internal Revenue Code is modified to read "24 percent."

(3) For each taxable year beginning on or after January 1, 2000, and before January 1, 2007, both of the following shall apply:

(A) The reference to “20 percent” in Section 41(a)(1) of the Internal Revenue Code is modified to read “15 percent.”

(B) The reference to “20 percent” in Section 41(a)(2) of the Internal Revenue Code is modified to read “24 percent.”

(4) For each taxable year beginning on or after January 1, 2007, both of the following shall apply:

(A) The reference to “20 percent” in Section 41(a)(1) of the Internal Revenue Code is modified to read “16 percent.”

(B) The reference to “20 percent” in Section 41(a)(2) of the Internal Revenue Code is modified to read “24 percent.”

(c) (1) With respect to any expense paid or incurred after the operative date of Section 6378, Section 41(b)(1) of the Internal Revenue Code is modified to exclude from the definition of “qualified research expense” any amount paid or incurred for tangible personal property that is eligible for the exemption from sales or use tax ~~provided by~~ under Section 6378.

(2) “Qualified research” and “basic research” shall include only research conducted in California.

(d) The provisions of Section 41(e)(7)(A) of the Internal Revenue Code, shall be modified so that “basic research,” for purposes of this section, includes any basic or applied research including scientific inquiry or original investigation for the advancement of scientific or engineering knowledge or the improved effectiveness of commercial products, except that the term does not include any of the following:

(1) Basic research conducted outside California.

(2) Basic research in the social sciences, arts, or humanities.

(3) Basic research for the purpose of improving a commercial product if the improvements relate to style, taste, cosmetic, or seasonal design factors.

(4) Any expenditure paid or incurred for the purpose of ascertaining the existence, location, extent, or quality of any deposit of ore or other mineral (including oil and gas).

(e) (1) In the case of a taxpayer engaged in any biopharmaceutical research activities that are described in codes 2833 to 2836, inclusive, or any research activities that are described in codes 3826, 3829, or 3841 to 3845, inclusive, of the Standard Industrial Classification (SIC) Manual published by the United

1 States Office of Management and Budget, 1987 edition, or any  
2 other biotechnology research and development activities, the  
3 provisions of Section 41(e)(6) of the Internal Revenue Code shall  
4 be modified to include both of the following:

5 (A) A qualified organization as described in Section  
6 170(b)(1)(A)(iii) of the Internal Revenue Code and owned by an  
7 institution of higher education as described in Section 3304(f) of  
8 the Internal Revenue Code.

9 (B) A charitable research hospital owned by an organization  
10 that is described in Section 501(c)(3) of the Internal Revenue Code,  
11 is exempt from taxation under Section 501(a) of the Internal  
12 Revenue Code, is not a private foundation, is designated a  
13 “specialized laboratory cancer center,” and has received Clinical  
14 Cancer Research Center status from the National Cancer Institute.

15 (2) For purposes of this subdivision:

16 (A) “Biopharmaceutical research activities” means those  
17 activities that use organisms or materials derived from organisms,  
18 and their cellular, subcellular, or molecular components, in order  
19 to provide pharmaceutical products for human or animal  
20 therapeutics and diagnostics. Biopharmaceutical activities make  
21 use of living organisms to make commercial products, as opposed  
22 to pharmaceutical activities that make use of chemical compounds  
23 to produce commercial products.

24 (B) “Other biotechnology research and development activities”  
25 means research and development activities consisting of the  
26 application of recombinant DNA technology to produce  
27 commercial products, as well as research and development  
28 activities regarding pharmaceutical delivery systems designed to  
29 provide a measure of control over the rate, duration, and site of  
30 pharmaceutical delivery.

31 (f) In the case where the credit allowed by this section exceeds  
32 the “tax,” the excess may be carried over to reduce the “tax” in  
33 the following year, and succeeding years if necessary, until the  
34 credit has been exhausted.

35 (g) For each taxable year beginning on or after January 1, 1998,  
36 the reference to “Section 501(a)” in Section 41(b)(3)(C) of the  
37 Internal Revenue Code, relating to contract research expenses, is  
38 modified to read “this part or Part 10 (commencing with Section  
39 17001).”



(h) (1) For each taxable year beginning on or after January 1, 2000, *and before January 1, 2007*:

(A) The reference to “2.65 percent” in Section 41(c)(4)(A)(i) of the Internal Revenue Code is modified to read “one and forty-nine hundredths of one percent.”

(B) The reference to “3.2 percent” in Section 41(c)(4)(A)(ii) of the Internal Revenue Code is modified to read “one and ninety-eight hundredths of one percent.”

(C) The reference to “3.75 percent” in Section 41(c)(4)(A)(iii) of the Internal Revenue Code is modified to read “two and forty-eight hundredths of one percent.”

(2) *For each taxable year beginning on or after January 1, 2007, the following apply:*

(A) *The reference to “2.65 percent” in Section 41(c)(4)(A)(i) of the Internal Revenue Code is modified to read “two percent.”*

(B) *The reference to “3.2 percent” in Section 41(c)(4)(A)(ii) of the Internal Revenue Code is modified to read “two and one-half percent.”*

(C) *The reference to “3.75 percent” in Section 41(c)(4)(A)(iii) of the Internal Revenue Code is modified to read “three percent.”*

(3) Section 41(c)(4)(B) shall not apply and in lieu thereof an election under Section 41(c)(4)(A) of the Internal Revenue Code may be made for any taxable year of the taxpayer beginning on or after January 1, 1998. That election shall apply to the taxable year for which made and all succeeding taxable years unless revoked with the consent of the Franchise Tax Board.

~~(3)~~

(4) Section 41(c)(6) of the Internal Revenue Code, relating to gross receipts, is modified to take into account only those gross receipts from the sale of property held primarily for sale to customers in the ordinary course of the taxpayer’s trade or business that is delivered or shipped to a purchaser within this state, regardless of f.o.b. point or any other condition of the sale.

(i) Section 41(h) of the Internal Revenue Code, relating to termination, shall not apply.

(j) Section 41(g) of the Internal Revenue Code, relating to special rule for passthrough of credit, is modified by each of the following:

(1) The last sentence shall not apply.

(2) If the amount determined under Section 41(a) of the Internal Revenue Code for any taxable year exceeds the limitation of Section 41(g) of the Internal Revenue Code, that amount may be carried over to other taxable years under the rules of subdivision (f), except that the limitation of Section 41(g) of the Internal Revenue Code shall be taken into account in each subsequent taxable year.

SEC. 7. Section 23636 of the Revenue and Taxation Code is amended to read:

23636. (a) For each taxable year beginning on or after January 1, 2001, and before January 1, 2006 \_\_\_\_\_, a qualified taxpayer shall be allowed as a credit against the “tax,” as defined in Section 23036, an amount equal to the following:

(1) Fifty percent of qualified wages paid or incurred during any taxable year beginning on or after January 1, 2001, and before January 1, 2002.

(2) Forty percent of qualified wages paid or incurred during any taxable year beginning on or after January 1, 2002, and before January 1, 2003.

(3) Thirty percent of the qualified wages paid or incurred during any taxable year beginning on or after January 1, 2003, and before January 1, 2004.

(4) Twenty percent of the qualified wages paid or incurred during any taxable year beginning on or after January 1, 2004, and before January 1, 2005.

(5) Ten percent of the qualified wages paid or incurred during any taxable year beginning on or after January 1, 2005, and before January 1, 2006 \_\_\_\_\_.

(b) For purposes of this section:

(1) (A) “Qualified taxpayer” means any taxpayer under an initial contract or subcontract to manufacture property for ultimate use in a Joint Strike Fighter or a Crew Exploration Vehicle.

(B) In the case of any ~~pass-through~~ *passthrough* entity, the determination of whether a taxpayer is a qualified taxpayer under this section shall be made at the entity level and any credit under this section or Section 17053.36 shall be allowed to the ~~pass-through~~ *passthrough* entity and passed through to the partners or shareholders in accordance with applicable provisions of Part 10 (commencing with Section 17001) or this part. For purposes

1 of this paragraph, ~~“pass-through”~~ “*passthrough* entity” means any  
2 partnership or S corporation.

3 (2) “Qualified wages” means that portion of wages paid or  
4 incurred by the qualified taxpayer during the taxable year with  
5 respect to qualified employees that are direct costs as defined in  
6 Section 263A of the Internal Revenue Code allocable to property  
7 manufactured in this state by the qualified taxpayer for ultimate  
8 use in a Joint Strike Fighter or a *Crew Exploration Vehicle*.

9 (3) “Qualified employee” means an individual whose services  
10 for the qualified taxpayer are performed in this state and are at  
11 least 90 percent directly related to the qualified taxpayer’s contract  
12 or subcontract to manufacture property for ultimate use in a Joint  
13 Strike Fighter or a *Crew Exploration Vehicle*.

14 (4) “Joint Strike Fighter” means the next generation air combat  
15 strike aircraft developed and produced under the Joint Strike  
16 Fighter program.

17 (5) “Joint Strike Fighter program” means the multiservice,  
18 multinational project conducted by the United States government  
19 to develop and produce the next generation of air combat strike  
20 aircraft.

21 (6) “*Crew Exploration Vehicle*” means the next generation  
22 spacecraft being planned by the National Aeronautics and Space  
23 Administration.

24 (c) The credit allowed by this section shall not exceed ten  
25 thousand dollars (\$10,000) per year, per qualified employee. For  
26 employees that are qualified employees for part of a taxable year,  
27 the credit shall not exceed ten thousand dollars (\$10,000) multiplied  
28 by a fraction, the numerator of which is the number of months of  
29 the taxable year that the employee is a qualified employee and the  
30 denominator of which is 12.

31 (d) In the case where the credit allowed by this section exceeds  
32 the “tax,” the excess may be carried over to reduce the “tax” in  
33 the following year, and the seven succeeding years if necessary,  
34 until the credit is exhausted.

35 (e) No credit shall be allowed unless the credit is reflected within  
36 the bid upon which the qualified taxpayer’s contract or subcontract  
37 to manufacture property for ultimate use in a Joint Strike-Fighter  
38 *Fighter or a Crew Exploration Vehicle* is based by reducing the  
39 amount of the bid by the amount of the credit allowable.

(f) All references to the credit and ultimate cost reductions incorporated into any successful bid that was awarded a contract or subcontract and for which a qualified taxpayer is making a claim shall be made available to the Franchise Tax Board upon request.

(g) This section shall remain in effect only until December 1, 2006 \_\_\_\_\_, and as of that date is repealed.

SEC. 8. Section 23637 of the Revenue and Taxation Code is amended to read:

23637. (a) For each taxable year beginning on or after January 1, 2001, and before January 1, 2006 \_\_\_\_\_, a qualified taxpayer shall be allowed as a credit against the “tax,” as defined in Section 23036, an amount equal to 10 percent of the qualified cost of qualified property that is placed in service in this state.

(b) (1) For purposes of this section, “qualified cost” means any costs that satisfy each of the following conditions:

(A) Except as otherwise provided in this subparagraph, is a cost paid or incurred by the qualified taxpayer for the construction, reconstruction, or acquisition of qualified property on or after January 1, 2001, and before January 1, 2006 \_\_\_\_\_. In the case of any qualified property constructed, reconstructed, or acquired by the qualified taxpayer (or any person related to the qualified taxpayer within the meaning of Section 267 or 707 of the Internal Revenue Code) pursuant to a binding contract in existence on or before January 1, 2001, costs paid pursuant to that contract shall be subject to allocation as follows. Contract costs shall be allocated to qualified property based on a ratio of costs actually paid prior to January 1, 2001, and total contract costs actually paid. “Cost paid” shall include, without limitation, contractual deposits and option payments. To the extent of costs allocated, whether or not currently deductible or depreciable for tax purposes, to a period prior to January 1, 2001, the cost shall be deemed allocated to property acquired before January 1, 2001, and is thus not a “qualified cost.”

(B) Except for capitalized labor costs as described in subparagraph (B) of paragraph (1) of subdivision (d), is an amount upon which the qualified taxpayer has paid, directly or indirectly, as a separately stated contract amount or as determined from the records of the qualified taxpayer, sales or use tax under Part 1 (commencing with Section 6001).

1 (C) Is an amount properly chargeable to the capital account of  
2 the qualified taxpayer.

3 (2) (A) For purposes of this subdivision, any contract entered  
4 into on or after January 1, 2001, that is a successor or replacement  
5 contract to a contract that was binding before January 1, 2001,  
6 shall be treated as a binding contract in existence before January  
7 1, 2001.

8 (B) If a successor or replacement contract is entered into on or  
9 after January 1, 2001, and the subject of the successor or  
10 replacement contract relates both to amounts for the construction,  
11 reconstruction, or acquisition of qualified property described in  
12 the original binding contract and to costs for the construction,  
13 reconstruction, or acquisition of qualified property not described  
14 in the original binding contract, then the portion of those amounts  
15 described in the successor or replacement contract that were not  
16 described in the original binding contract shall not be treated as  
17 costs paid or incurred pursuant to a binding contract in existence  
18 on or prior to January 1, 2001, under subparagraph (A) of paragraph  
19 (1).

20 (3) (A) For purposes of this section, an option contract in  
21 existence before January 1, 2001, under which a qualified taxpayer  
22 (or any other person related to the qualified taxpayer within the  
23 meaning of Section 267 or 707 of the Internal Revenue Code) had  
24 an option to acquire qualified property, shall be treated as a binding  
25 contract under the rules in paragraph (2). For purposes of this  
26 subparagraph, an option contract shall not include an option under  
27 which the optionholder will forfeit an amount less than 10 percent  
28 of the fixed option price in the event the option is not exercised.

29 (B) For purposes of this section, a contract shall be treated as  
30 binding even if the contract is subject to a condition.

31 (c) (1) For purposes of this section, “qualified taxpayer” means  
32 any taxpayer under an initial contract or subcontract to manufacture  
33 property for ultimate use in a Joint Strike Fighter *or a Crew*  
34 *Exploration Vehicle*.

35 (2) In the case of any passthrough entity, the determination of  
36 whether a taxpayer is a qualified taxpayer under this section shall  
37 be made at the entity level and any credit under this section or  
38 Section 17053.37 shall be allowed to the passthrough entity and  
39 passed through to the partners or shareholders in accordance with  
40 applicable provisions of Part 10 (commencing with Section 17001)

1 or Part 11 (commencing with Section 23001). For purposes of this  
2 paragraph, the term “passthrough entity” means any partnership  
3 or ~~S~~ “S” corporation.

4 (3) The Franchise Tax Board may prescribe regulations to carry  
5 out the purposes of this section, including any regulations necessary  
6 to prevent the avoidance of the effect of this section through  
7 splitups, shell corporations, partnerships, tiered ownership  
8 structures, sale-leaseback transactions, or otherwise.

9 (d) (1) For purposes of this section, “qualified property” means  
10 property that is described as either of the following:

11 (A) Tangible personal property that is defined in Section  
12 1245(a)(3)(A) of the Internal Revenue Code for use by a qualified  
13 taxpayer primarily in qualified activities to manufacture a product  
14 for ultimate use in a Joint Strike Fighter *or a Crew Exploration*  
15 *Vehicle*.

16 (B) The value of any capitalized labor costs that are direct costs  
17 as defined in Section 263A of the Internal Revenue Code allocable  
18 to the construction or modification of property described in  
19 subparagraph (A).

20 (2) Qualified property does not include any of the following:

21 (A) Furniture.

22 (B) Inventory.

23 (C) Equipment used to store finished products that have  
24 completed the manufacturing process.

25 (D) Any tangible personal property that is used in administration,  
26 general management, or marketing.

27 (e) For purposes of this section:

28 (1) “*Crew Exploration Vehicle*” means the next generation  
29 spacecraft being planned by the National Aeronautics and Space  
30 Administration.

31 (2) “Fabricating” means to make, build, create, produce, or  
32 assemble components or property to work in a new or different  
33 manner.

34 ~~(2)~~

35 (3) “Joint Strike Fighter” means the next generation air combat  
36 strike aircraft developed and produced under the Joint Strike  
37 Fighter program.

38 ~~(3)~~

39 (4) “Joint Strike Fighter program” means the multiservice,  
40 multinational project conducted by the United States government

1 to develop and produce the next generation of air combat strike  
2 aircraft.

3 ~~(4)~~

4 (5) “Manufacturing” means the activity of converting or  
5 conditioning property by changing the form, composition, quality,  
6 or character of the property for ultimate use in a Joint Strike Fighter  
7 *or a Crew Exploration Vehicle*. Manufacturing includes any  
8 improvements to tangible personal property that result in a greater  
9 service life or greater functionality than that of the original  
10 property.

11 ~~(5)~~

12 (6) “Primarily” means tangible personal property used 50 percent  
13 or more of the time in an activity described in subparagraph (A)  
14 of paragraph (1) of subdivision (d).

15 ~~(6)~~

16 (7) “Process” means the period beginning at the point at which  
17 any raw materials are received by the qualified taxpayer and  
18 introduced into the manufacturing, processing, or fabricating  
19 activity of the qualified taxpayer and ending at the point at which  
20 the manufacturing, processing, or fabricating activity of the  
21 qualified taxpayer has altered tangible personal property to its  
22 completed form, including packaging, if required. Raw materials  
23 shall be considered to have been introduced into the process when  
24 the raw materials are stored on the same premises where the  
25 qualified taxpayer’s manufacturing, processing, or fabricating  
26 activity is conducted. Raw materials that are stored on premises  
27 other than where the qualified taxpayer’s manufacturing,  
28 processing, or fabricating activity is conducted, shall not be  
29 considered to have been introduced into the manufacturing,  
30 processing, or fabricating process.

31 ~~(7)~~

32 (8) “Processing” means the physical application of the materials  
33 and labor necessary to modify or change the characteristics of  
34 property.

35 ~~(8)~~

36 (9) “Qualified activities” means manufacturing, processing, or  
37 fabricating of property, beginning at the point at which any raw  
38 materials are received by the qualified taxpayer and introduced  
39 into the process and ending at the point at which the manufacturing,

1 processing, or fabricating has altered tangible personal property  
2 to its completed form, including packaging, if required.

3 (f) The credit allowed under subdivision (a) shall apply to  
4 qualified property that is acquired by or subject to lease by a  
5 qualified taxpayer, subject to the following special rules:

6 (1) A lessor of qualified property, irrespective of whether the  
7 lessor is a qualified taxpayer, shall not be allowed the credit  
8 provided under subdivision (a) with respect to any qualified  
9 property leased to another qualified taxpayer.

10 (2) For purposes of paragraphs (2) and (3) of subdivision (b),  
11 “binding contract” includes any lease agreement with respect to  
12 the qualified property.

13 (3) (A) For purposes of determining the qualified cost paid or  
14 incurred by a lessee in any leasing transaction that is not treated  
15 as a sale under Part 1 (commencing with Section 6001), the  
16 following rules shall apply:

17 (i) Except as provided by subparagraph (C) of this paragraph,  
18 subparagraphs (A) and (C) of paragraph (1) of subdivision (b) shall  
19 not apply.

20 (ii) Except as provided in subparagraph (B) and clause (iii), the  
21 “qualified cost” upon which the lessee shall compute the credit  
22 provided under this section shall be equal to the original cost to  
23 the lessor (within the meaning of Section 18031) of the qualified  
24 property that is the subject of the lease.

25 (iii) The requirement of subparagraph (B) of paragraph (1) of  
26 subdivision (b) shall be treated as satisfied only if the lessor has  
27 made a timely election under either Section 6094.1 or subdivision  
28 (d) of Section 6244 and has paid sales tax reimbursement or use  
29 tax measured by the purchase price of the qualified property (within  
30 the meaning of paragraph (5) of subdivision (g) of Section 6006).  
31 For purposes of this subdivision, the amount of original cost to  
32 the lessor which may be taken into account under clause (ii) shall  
33 not exceed the purchase price upon which sales tax reimbursement  
34 or use tax has been paid under the preceding sentence.

35 (B) For purposes of applying subparagraph (A) only, the  
36 following special rules shall apply:

37 (i) The original cost to the lessor of the qualified property shall  
38 be reduced by the amount of any original cost of that property that  
39 was taken into account by a predecessor lessee in computing the  
40 credit allowable under this section.



1 (ii) Clause (i) shall not apply in any case where the predecessor  
2 lessee was required to recapture the credit provided under this  
3 section pursuant to the provisions of subdivision (g).

4 (iii) For purposes of this section only, in any case where a  
5 successor lessor has acquired qualified property from a predecessor  
6 lessor in a transaction not treated as a sale under Part 1  
7 (commencing with Section 6001), the original cost to the successor  
8 lessor of the qualified property shall be reduced by the amount of  
9 the original cost of the qualified property that was taken into  
10 account by any lessee of the predecessor lessor in computing the  
11 credit allowable under this section.

12 (C) In determining the original cost of any qualified property  
13 under this paragraph, only amounts paid or incurred by the lessor  
14 on or after January 1, 2001, and before January 1, ~~2006~~\_\_\_\_\_,  
15 shall be taken into account. In the case of any qualified property  
16 constructed, reconstructed, or acquired by a lessor pursuant to a  
17 binding contract in existence on or prior to January 1, 2001, the  
18 allocation rule specified in subparagraph (A) of paragraph (1) of  
19 subdivision (b) shall apply in determining the original cost to the  
20 lessor of qualified property.

21 (D) Notwithstanding subparagraph (A), in the case of any leasing  
22 transaction for which the lessee is allowed the credit under this  
23 section and thereafter the lessee (or any party related to the lessee  
24 within the meaning of Section 267 or 318 of the Internal Revenue  
25 Code) acquires the qualified property from the lessor (or any  
26 successor lessor) within one year from the date the qualified  
27 property is first used by the lessee under the terms of the lease, the  
28 lessee's (or related party's) acquisition of the qualified property  
29 from the lessor (or successor lessor) shall be treated as a disposition  
30 by the lessee of the qualified property that was subject to the lease  
31 under subdivision (g).

32 (4) For purposes of determining the qualified cost paid or  
33 incurred by a lessee in any leasing transaction that is treated as a  
34 sale under Part 1 (commencing with Section 6001), the following  
35 rules shall apply:

36 (A) Subparagraph (A) of paragraph (1) of subdivision (b) shall  
37 be applied by substituting the term "purchase" for the term  
38 "construction, reconstruction, or acquisition."

39 (B) Subparagraph (C) of paragraph (1) of subdivision (b) shall  
40 apply.

1 (C) The requirement of subparagraph (B) of paragraph (1) of  
2 subdivision (b) shall be treated as satisfied at the time that either  
3 the lessor or the qualified taxpayer pays sales or use tax under Part  
4 1 (commencing with Section 6001).

5 (5) (A) In the case of any leasing transaction described in  
6 paragraph (3), the lessor shall provide a statement to the lessee  
7 specifying the amount of the lessor's original cost of the qualified  
8 property and the amount of that cost upon which a sales or use tax  
9 was paid within 45 days after the close of the lessee's taxable year  
10 in which the credit is allowable to the lessee under this section.

11 (B) The statement required under subparagraph (A) shall be  
12 made available to the Franchise Tax Board upon request.

13 (g) No credit shall be allowed if the qualified property is  
14 removed from the state, is disposed of to an unrelated party, or is  
15 used for any purpose not qualifying for the credit provided in this  
16 section in the same taxable year in which the taxpayer first places  
17 the qualified property in service in this state. If any qualified  
18 property for which a credit is allowed pursuant to this section is  
19 thereafter removed from this state, disposed of to an unrelated  
20 party, or used for any purpose not qualifying for the credit provided  
21 in this section within one year from the date the taxpayer first  
22 places the qualified property in service in this state, the amount of  
23 the credit allowed by this section for that qualified property shall  
24 be recaptured by adding that credit amount to the tax of the  
25 qualified taxpayer for the taxable year in which the qualified  
26 property is disposed of, removed, or put to an ineligible use.

27 (h) In the case where the credit allowed by this section exceeds  
28 the "tax," the excess may be carried over to reduce the "tax" in  
29 the following year, and the seven succeeding years if necessary,  
30 until the credit is exhausted.

31 (i) (1) No credit shall be allowed under this section if a credit  
32 is claimed under Section 23649 in connection with the same  
33 property.

34 (2) No credit shall be allowed unless the credit is reflected within  
35 the bid upon which the qualified taxpayer's contract or subcontract  
36 to manufacture property for ultimate use in a Joint Strike Fighter  
37 *or a Crew Exploration Vehicle* is based by reducing the amount  
38 of the bid by the amount of the credit allowable.

39 (j) All references to the credit and ultimate cost reductions  
40 incorporated into any successful bid that was awarded a contract

1 or subcontract and for which a qualified taxpayer is making a claim  
2 shall be made available to the Franchise Tax Board upon request.

3 (k) This section shall remain in effect only until December 1,  
4 2006 \_\_\_\_, and as of that date is repealed.

5 SEC. 9. Section 25120 of the Revenue and Taxation Code is  
6 amended to read:

7 25120. As used in Sections 25120 to 25139, inclusive, which  
8 shall hereafter be referred to as “this act,” unless the context  
9 otherwise requires:

10 (a) (1) “Business income” means income arising from  
11 transactions and activity in the regular course of the taxpayer’s  
12 trade or business and includes *all income arising from the treasury*  
13 *function of the taxpayer’s trade or business* and income from  
14 tangible and intangible property if the acquisition, management,  
15 and disposition of the property constitute integral parts of the  
16 taxpayer’s regular trade or business operations.

17 (2) “*Income arising from the treasury function*” means interest,  
18 dividends, and any overall net gain realized from transactions  
19 undertaken as part of the treasury function of the taxpayer’s trade  
20 or business.

21 (b) “Commercial domicile” means the principal place from  
22 which the trade or business of the taxpayer is directed or managed.

23 (c) “Compensation” means wages, salaries, commissions and  
24 any other form of remuneration paid to employees for personal  
25 services.

26 (d) “Nonbusiness income” means all income other than business  
27 income.

28 (e) (1) “Sales” means all gross receipts of the taxpayer not  
29 allocated under Sections 25123 through 25127 of this code.

30 ~~(f)~~

31 (2) (A) *Notwithstanding Section 38006, gross receipts arising*  
32 *from a treasury function shall be limited to the overall net gain,*  
33 *including interest and dividends, realized from transactions*  
34 *undertaken as part of a treasury function.*

35 (B) *Subparagraph (A) does not apply to the activities of a*  
36 *broker-dealer that is registered with the Securities and Exchange*  
37 *Commission or equivalent federal agency.*

38 (f) *For purposes of this section, all of the following definitions*  
39 *apply:*

1 (1) “Treasury function” means the pooling, management, and  
2 investment of liquid assets. “Treasury function” does not include  
3 a taxpayer’s trading function that purchases and sells future  
4 contracts, products, or commodities related to the business of the  
5 taxpayer, or related to hedging price risk of the products or  
6 commodities consumed, produced, or sold by the taxpayer.

7 (2) (A) “Liquid asset” means a readily marketable intangible,  
8 including, but not limited to, bonds, stocks, future contracts,  
9 debentures, options warrants, foreign currency, and mutual funds  
10 that hold those intangibles. “Liquid asset” does not mean currency  
11 held in bank accounts if that is the currency that the business  
12 regularly used in the conduct of its trade or business, unless that  
13 currency is an instrument that may be purchased or sold for a gain  
14 or loss.

15 (B) An intangible is considered “marketable” if it is traded on  
16 an established stock or securities exchange or market and is  
17 regularly quoted by brokers or dealers.

18 (g) “State” means any state of the United States, the District of  
19 Columbia, the Commonwealth of Puerto Rico, any territory or  
20 possession of the United States, and any foreign country or political  
21 subdivision thereof.

22 (h) The amendments made to this section by the act adding this  
23 subdivision shall be operative for taxable years beginning on or  
24 after January 1, 2006.

25 SEC. 10. Section 25128 of the Revenue and Taxation Code is  
26 amended to read:

27 25128. (a) Notwithstanding Section 38006, for taxable years  
28 beginning before January 1, 2007, and for taxable years beginning  
29 on or after January 1,\_\_\_\_, all business income shall be  
30 apportioned to this state by multiplying the business income by a  
31 fraction, the numerator of which is the property factor plus the  
32 payroll factor plus twice the sales factor, and the denominator of  
33 which is four, except as provided in subdivision (b) or (c).

34 (b) If an apportioning trade or business derives more than 50  
35 percent of its “gross business receipts” from conducting one or  
36 more qualified business activities, all business income of the  
37 apportioning trade or business shall be apportioned to this state by  
38 multiplying business income by a fraction, the numerator of which  
39 is the property factor plus the payroll factor plus the sales factor,  
40 and the denominator of which is three.

1 (c) For purposes of this section, a “qualified business activity”  
2 means the following:

- 3 (1) An agricultural business activity.
- 4 (2) An extractive business activity.
- 5 (3) A savings and loan activity.
- 6 (4) A banking or financial business activity.

7 (d) For purposes of this section:

8 (1) “Gross business receipts” means gross receipts described in  
9 subdivision (e) of Section 25120 (other than gross receipts from  
10 sales or other transactions within an apportioning trade or business  
11 between members of a group of corporations whose income and  
12 apportionment factors are required to be included in a combined  
13 report under Section 25101, limited, if applicable, by Section  
14 25110), whether or not the receipts are excluded from the sales  
15 factor by operation of Section 25137.

16 (2) “Agricultural business activity” means activities relating to  
17 any stock, dairy, poultry, fruit, furbearing animal, or truck farm,  
18 plantation, ranch, nursery, or range. “Agricultural business activity”  
19 also includes activities relating to cultivating the soil or raising or  
20 harvesting any agricultural or horticultural commodity, including,  
21 but not limited to, the raising, shearing, feeding, caring for, training,  
22 or management of animals on a farm as well as the handling,  
23 drying, packing, grading, or storing on a farm any agricultural or  
24 horticultural commodity in its unmanufactured state, but only if  
25 the owner, tenant, or operator of the farm regularly produces more  
26 than one-half of the commodity so treated.

27 (3) “Extractive business activity” means activities relating to  
28 the production, refining, or processing of oil, natural gas, or mineral  
29 ore.

30 (4) “Savings and loan activity” means any activities performed  
31 by savings and loan associations or savings banks which have been  
32 chartered by federal or state law.

33 (5) “Banking or financial business activity” means activities  
34 attributable to dealings in money or moneyed capital in substantial  
35 competition with the business of national banks.

36 (6) “Apportioning trade or business” means a distinct trade or  
37 business whose business income is required to be apportioned  
38 under Sections 25101 and 25120, limited, if applicable, by Section  
39 25110, using the same denominator for each of the applicable  
40 payroll, property, and sales factors.

(7) Paragraph (4) of subdivision (c) shall apply only if the Franchise Tax Board adopts the Proposed Multistate Tax Commission Formula for the Uniform Apportionment of Net Income from Financial Institutions, or its substantial equivalent, and shall become operative upon the same operative date as the adopted formula.

(8) In any case where the income and apportionment factors of two or more savings associations or corporations are required to be included in a combined report under Section 25101, limited, if applicable, by Section 25110, both of the following shall apply:

(A) The application of the more than 50 percent test of subdivision (b) shall be made with respect to the “gross business receipts” of the entire apportioning trade or business of the group.

(B) The entire business income of the group shall be apportioned in accordance with either subdivision (a) or (b), as applicable.

SEC. 11. Section 25128 is added to the Revenue and Taxation Code, to read:

25128. (a) Notwithstanding Section 38006, for taxable years beginning on or after January 1, 2007, and before January 1, \_\_\_\_, all business income of an apportioning trade or business shall be apportioned to this state by multiplying the business income by a fraction, the numerator of which is the property factor plus the payroll factor plus twice the sales factor and the denominator of which is four, except as provided in subdivision (b), (c), or (e).

(b) (1) If an apportioning trade or business is a qualified taxpayer, the qualified taxpayer may elect to have all business income apportioned to this state for taxable years beginning on or after January 1, 2007, and before January 1, \_\_\_\_, by multiplying the business income by a fraction, the numerator of which is the property factor plus the payroll factor plus four times the sales factor, and the denominator of which is six. The Franchise Tax Board shall prescribe the form and manner for making the election under this paragraph. No election may be made for a taxable year beginning prior to January 1, 2007.

(2) A qualified taxpayer making the election under this subdivision shall source sales of prewritten software as tangible personal property pursuant to Section 25135, without regard to method of delivery.

(3) (A) For purposes of this section, “qualified taxpayer” means an apportioning trade or business that derives more than 50 percent

1 of its “gross business receipts” from conducting a business activity,  
2 or combination of activities, described in Principal Business  
3 Activity Code (PBAC) 312130, 325410, 333200 (to the extent of  
4 semiconductor machinery manufacturing only), 334110, 334200,  
5 334410, 339110, 511210, 517000, 512100, 515100, 515210, or  
6 713100 as prescribed by the Internal Revenue Service.

7 (B) A taxpayer that does not satisfy the requirements of  
8 subparagraph (A) and that derives more than one billion dollars  
9 (\$1,000,000,000) of “gross business receipts” from conducting a  
10 business activity or combination of activities described in PBAC  
11 312130, 325410, 333200 (to the extent of semiconductor machinery  
12 manufacturing only), 334110, 334200, 334410, 339110, 511210,  
13 517000, 512100, 515100, 515210, or 713100 may elect, on a timely  
14 filed original return, to be a qualified taxpayer and to multiply  
15 business income by a fraction (hereinafter referred to as the  
16 “applicable percentage”), the numerator and the denominator of  
17 which shall be determined as set forth under paragraph (1) of  
18 subdivision (b). The application of the more than one billion dollars  
19 (\$1,000,000,000) test shall be made with respect to the combined  
20 “gross business receipts” of all members of the apportioning trade  
21 or business that are engaged in one or more activities described in  
22 this subparagraph.

23 The one-time binding election under this subparagraph shall be  
24 made by contract with the Franchise Tax Board in the original  
25 return. The Franchise Tax Board shall prescribe the form and  
26 manner for making the election under this subparagraph. No  
27 election may be made for a taxable year beginning prior to January  
28 1, 2007.

29 (C) For purposes of subparagraph (B), “qualified taxpayer”  
30 includes all members of the apportioning trade or business that are  
31 engaged in one or more activities described in subparagraph (B).

32 (D) If a qualified taxpayer described in subparagraph (B) is  
33 included in a single combined report under Section 25101 or 25110  
34 with one or more taxpayers that are not qualified taxpayers, to  
35 apportion the business income of the entire combined group, both  
36 of the following shall apply:

37 (i) The numerator of each factor for the qualified taxpayer shall  
38 be the denominator of the factor for the qualified taxpayer  
39 multiplied by the applicable percentage described in subparagraph  
40 (B) for that qualified taxpayer.

(ii) The numerators for each of the factors under this subparagraph shall be added to the numerators of the other members of the combined group when determining the apportionment factor that will be used by the combined group.

(c) (1) If an apportioning trade or business derives more than 50 percent of its “gross business receipts” from conducting a business activity, or combination of activities, described in PBAC 211110, 221210, 324110, 324190, 424700, 425120, 447100, 454312, 486000, or 523130 as prescribed by the Internal Revenue Service, the taxpayer may elect on a timely filed original return to apportion all business income of the apportioning trade or business to this state either in the same manner as a qualified taxpayer pursuant to subdivision (b), or by multiplying business income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor and the denominator of which is three.

(2) The one-time binding election under paragraph (1) shall be made by contract with the Franchise Tax Board in the original return. The Franchise Tax Board shall prescribe the form and manner for making the election. No election may be made for a taxable year beginning prior to January 1, 2007.

(d) An election under subdivision (b) or (c) may be terminated by the taxpayer if either of the following occurs:

(1) The taxpayer is acquired directly or indirectly by a nonelecting entity that alone or together with those affiliates included in its combined report is larger than the taxpayer as measured by equity capital.

(2) With the permission of the Franchise Tax Board.

(e) If an apportioning trade or business derives more than 50 percent of its gross business receipts from conducting one or more qualified business activities, all business income of the apportioning trade or business shall be apportioned to this state by multiplying the business income by a fraction, the numerator of which is the property factor plus the payroll factor plus the sales factor and the denominator of which is three.

For purposes of this subdivision, a “qualified business activity” means the following:

(1) An agricultural business activity.

(2) A savings and loan activity.

(3) A banking or financial business activity.



(f) For purposes of this section, all of the following definitions apply:

(1) (A) “Gross business receipts” means gross receipts described in subdivision (e) of Section 25120, other than gross receipts from sales or other transactions within an apportioning trade or business between members of a group of corporations whose income and apportionment factors are required to be included in a combined report under Section 25101, limited, if applicable, by Section 25110, whether or not the receipts are excluded from the sales factor by operation of Section 25137.

(B) “Gross business receipts” does not include sales arising from a treasury function of the taxpayer’s trade or business, as defined in subdivision (f) of Section 25120.

(2) (A) “Apportioning trade or business” means a distinct trade or business whose business income is required to be apportioned under Sections 25101 and 25120, limited, if applicable, by Section 25110, using the same denominator for each of the applicable payroll, property, and sales factors.

(B) In any case where the income and apportionment factors of two or more savings and loan associations, banks, or corporations as described in subdivision (b), (c), or (e) are required to be included in a combined report under Section 25101, limited, if applicable, by Section 25110, both of the following shall apply:

(i) The application of the more than 50-percent test of subdivision (b), (c), or (e) shall be made with respect to the “gross business receipts” of the entire apportioning trade or business of the group.

(ii) The entire business income of the group shall be apportioned in accordance with subdivision (b), (c), or (e), as applicable.

(3) “Agricultural business activity” means activities relating to any stock, dairy, poultry, fruit, furbearing animal, or truck farm, plantation, ranch, nursery, or range. “Agricultural business activity” also includes activities relating to cultivating the soil or raising or harvesting any agricultural or horticultural commodity, including, but not limited to, the raising, shearing, feeding, caring for, training, or management of animals on a farm as well as the handling, drying, packing, grading, or storing on a farm any agricultural or horticultural commodity in its unmanufactured state, but only if the owner, tenant, or operator of the farm regularly produces more than one-half of the commodity so treated.

1 (4) “Savings and loan activity” means any activities performed  
2 by savings and loan associations or savings banks that have been  
3 chartered by federal or state law.

4 (5) “Banking or financial business activity” means activities  
5 attributable to dealings in money or moneyed capital in substantial  
6 competition with the business of national banks.

7 (6) “Equity capital” means issued stock of any class, paid-in  
8 capital and retained earnings, or earned surplus, as set forth on the  
9 balance sheet of the taxpayer or the nonelecting entity, for the  
10 immediately preceding year-end accounting period.

11 (7) All references to Principal Business Activity Codes are as  
12 prescribed by the Internal Revenue Service on December 31, 2005.

13 (g) Any change in the apportionment formula caused by this  
14 section is not consideration for granting a change of the  
15 water’s-edge election pursuant to Section 25113.

16 (h) If this section or any portion of this section is held invalid,  
17 or the application of this section to any person or circumstance is  
18 held invalid, that invalidity shall not affect other provisions of the  
19 act adding this section, or the provisions of this section that can  
20 be reasonably separated pursuant to Section 23057.

21 (i) This section shall become operative on January 1, 2007, and  
22 shall remain in effect only until January 1, \_\_\_\_, and of the date  
23 is repealed unless a later enacted statute, which is chaptered before  
24 January 1, \_\_\_\_, deletes or extends that date.

25 SEC. 12. Any governing body of any county, city, or district  
26 that votes to allow the exemption provided in Section 6357.7 of  
27 the Revenue and Taxation Code shall notify the State Board of  
28 Equalization on or before December 1, 2006.

29 SEC. 13. This act provides for a tax levy within the meaning  
30 of Article IV of the Constitution and shall go into immediate effect.